The implementation of a balanced scorecard perspective to SMEs performance

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Abstract

This paper aims to investigate the impact of implementing the balanced scorecard perspective on the performance of micro, small, and medium enterprises (SMEs) in the F&B, fashion, craft, and services sectors in Central Java and Yogyakarta. A total of 170 respondents participated in the online and offline survey, and after removing incomplete data, 164 observations were analysed. The balanced scorecard perspective, consisting of financial, customer, internal process, and organizational learning and growth perspectives, was used as an independent variable, while performance was used as a dependent variable. The research also included digitalization and control variables such as gender, education sector, and size of SMEs. The results suggest that customer satisfaction and loyalty significantly affect SMEs' performance and profitability. Testing the implementation of the balanced scorecard across various sectors, the research finds that its effects are not significant in sectors such as fashion, craft, services, and others sectors. The research recommends emphasizing the importance of maintaining a positive relationship with customers to increase revenue and profitability. Though financial and learning variables did not have significant effects, SMEs should still consider them as they may lead to customer satisfaction.

Keywords: Balanced scorecard; SMEs; performance; customer satisfaction

1. Introduction

The balanced scorecard (BSC) is a strategic management tool that can provide a comprehensive framework for measuring and managing organizational performance across various perspectives, such as financial, customer, internal processes, and learning and growth. While the BSC has been widely studied and popular in large organizations, there is a significant research gap concerning its implementation in small and medium-sized enterprises (SMEs). This research gap focuses on understanding the challenges, benefits, and outcomes of BSC implementation specifically in the context of SMEs.

First, limited research on BSC adaptation in SMEs. Despite the growing importance of SMEs in the global economy, there is limited empirical research on how SMEs adapt and implement the BSC framework. Most of the existing literature on the BSC primarily focuses on its implementation in large organizations. Therefore, there is a need for research that explores the unique challenges and factors influencing BSC implementation in the SME context.

Second, SMEs differ significantly from large organizations in terms of available resources, organizational structure, and managerial capabilities. These differences may necessitate the adaptation of the BSC framework to suit the specific needs and characteristics of SMEs. There is a research gap in understanding how SMEs can effectively tailor the BSC framework to their organizational context, considering factors such as limited resources, less formalized structures, and the importance of agility and flexibility.

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Third, while the BSC is widely recognized as a performance measurement and management tool, the specific effects of BSC implementation on SME performance remain understudied. Research is needed to investigate the relationship between BSC implementation and various performance outcomes in SMEs, such as financial performance, customer satisfaction, operational efficiency, innovation, and employee satisfaction. Understanding these relationships will provide insights to improve SMEs' performance by maximizing BSC effectiveness.

Small and Medium-sized Enterprises (SMEs) play a pivotal role in the global economy by contributing significantly to employment generation, fostering innovation, and propelling economic growth. These businesses are distinct from their large-scale counterparts, exhibiting specific attributes that define their unique character. Several key characteristics set SMEs apart:

Firstly, SMEs are delineated by their size and employee count. While the precise criteria for classifying SMEs may vary from one country to another, a common thread is that they generally have fewer employees and generate lower annual revenue compared to larger organizations. This relatively modest scale affords SMEs greater flexibility, adaptability, and agility in responding to market dynamics. The streamlined size allows for quicker decision-making processes, enabling these enterprises to navigate changes and seize opportunities with a nimble approach.

Second, SMEs are often privately owned and operated by a small number of individuals or families. SMEs' ownership and management structure are closely intertwined, with the owners often playing a direct role in the day-to-day operations. This hands-on approach enables quicker decision-making and more personalized relationships with employees, customers, and suppliers.

Third, SMEs tend to focus on local or niche markets rather than aiming for broad international reach. Their limited resources and market presence make it more practical to target specific customer segments or operate within a local geographic area. This localized focus allows SMEs to develop strong customer relationships and cater to specific market needs.

Fourth, SMEs often face resource constraints, including limited financial capital, human resources, and technological capabilities. This scarcity of resources poses challenges but also encourages creativity, innovation, and efficiency. SMEs need to prioritize their resource allocation and find innovative ways to compete with large organizations. Fifth, compared to large organizations, SMEs often have less formalized organizational structures and processes. The decision-making process is typically more decentralized and flexible, allowing for quicker responses to market demands. However, as SMEs grow, they may need to establish more formal structures to maintain efficiency and effectiveness.

Micro, small, and medium businesses usually called SMEs have important roles in developing countries. They are potentially being a growth engine of the economy, and also a source of employment (Tambunan, 2011). According to IFC (2011), for the trade and service industry there are 72% of SMEs operate in this sector, besides 20% in manufacturing, and agriculture, and 8% in other sectors, respectively. In Indonesia, SMEs have a higher growth compared to large business sectors. The Ministry of Cooperatives and SMEs Republic of Indonesia data from 2016-2019 explains the growth of new business is 1.98% respectively and the number of SMEs in Indonesia currently reaches 64.4 million. The SMEs in Indonesia can absorb 97% of the total workforce and collect up to 60.4% of the total investment.

In 2021, SMEs contributed to Indonesia's GDP by 61.07%, it is worth about 8,573.89 trillion rupiahs (Coordinating Ministry for Economic Affairs Republic Indonesia, 2021). Because of the importance of SMEs in Indonesia, they need to be developed. Business development can never be separated from measuring company performance as the basis for building the strategy. Performance measurement must be connected to all business strategies and should include financial and non-financial criteria of organizations that can build into their programs, investments, and acquisitions to achieve the targets. In terms of performance in the hotel business, it explains the need for business people to consider quantitative and qualitative metrics and then a performance innovation perspective (Bentes et al., 2012; Sainaghi et al., 2013; Sutheewasinnon et al., 2016).

2. Literature review

The balanced scorecard was introduced by Robert Kaplan and David Norton in 1992 after conducting research in 12 companies. The balanced scorecard concept was born from companies that cannot determine performance into numbers from the results of managing intangible assets owned by

the company (Kaplan, 2009). The performance measurement framework appears amid various difficulties in converting the company's performance into figures, especially those that are not related to finance, for example, the company's assets in human resources. The concept of a balanced scorecard contained in the basic framework drawing for the strategic map makes it easier for companies to convert intangible assets into outputs that can be used as references to assess company performance and can plan future strategies to improve company performance as needed.

Figure 1. The basic framework for a strategy map
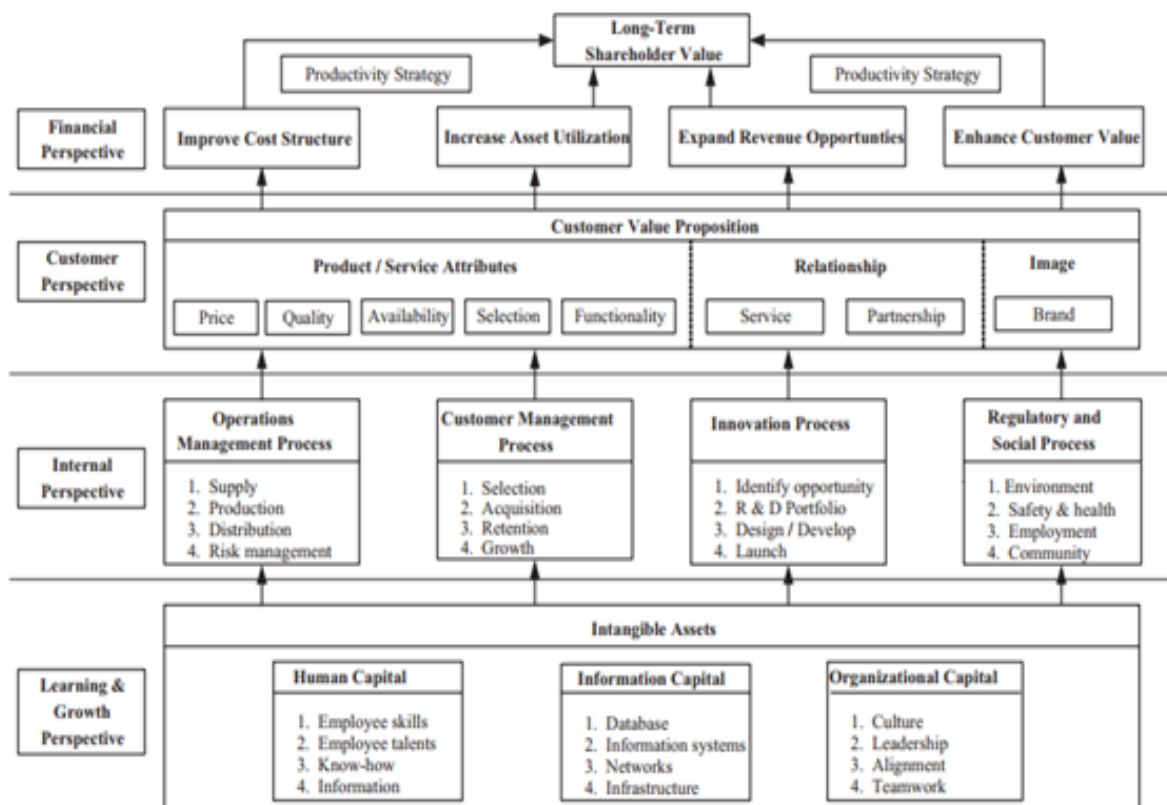
Source: Kaplan & Norton (2004)

That map aims to provide a comprehensive understanding of the key elements and components of the Balanced Scorecard, drawing from existing theories and models in the literature.

➢ Performance Measurement and Management: The foundation of the Balanced Scorecard is the concept of performance measurement and management. Various theories and models contribute to this aspect, including the Performance Measurement Framework Neely et al. (1995) and the Performance Management System Fitzgerald et al. (1996). These theories emphasize the importance of setting strategic objectives, identifying key performance indicators (KPIs), and aligning organizational performance measures with their objectives.

➢ Strategy Mapping and Alignment: The BSC helps organizations translate their strategic objectives into operational actions through strategy mapping. The Strategy-Focused Organization model Kaplan and Norton (2001) provides a theoretical basis for this component. It highlights the need to establish a clear cause-and-effect relationship between strategic objectives and operational measures across different perspectives, including financial, customer, internal processes, and learning and growth.

➢ Multiple Perspectives: The BSC incorporates multiple perspectives to provide a balanced view of organizational performance. These perspectives include the financial, customer, internal process, and learning and growth. The Multiple Constituencies Theory Zajac and Westphal (1996) and the Stakeholder Theory Freeman (1984) contribute to this aspect, emphasizing the importance of considering the needs and stakeholders' expectations when designing performance measures.

➢ Cascading and Alignment: The BSC promotes cascading and alignment of objectives and measures throughout the organization. The Cascading Balanced Scorecard model Niven (2002) provides a theoretical foundation for this component. It suggests that each organizational unit should develop its scorecard aligned with the higher-level scorecards, ensuring consistency and alignment of objectives from top to bottom.

➢ Strategic Learning and Adaptation: Based on performance feedback, BSC provides a learning and adaptation strategy. The Organizational Learning Theory Argyris and Schön (1978) and the Dynamic Capabilities Theory Teece et al. (1997) contribute to this aspect. These theories emphasize the importance of continuous learning, knowledge creation, and adaptability to drive organizational success and performance improvement.

Literature reveals that numerous organizations have adopted the balanced scorecard approach in many forms with fairly consistent and positive results (Tompson and Mathys, 2008). According to Wu (2012), through a balanced scorecard, management can have effective communication with employees, and it also controls the development of strategic progress in order to increase the performance and organization's competitiveness. It also prescribes what an organization should measure and translates vision and strategy. In addition, it can be used as a tool to find the most strategic implementation for performance through continual improvements. Although found to be widespread in large organizations, literature that examines the uses and limitations of the Balanced Scorecard in SMEs is still rare (Rompho, 2011). The theoretical framework of the implementation of BSC in SMEs:

- Change Management Theories:
Change management theories, such as The Kotter's 8-Step Model Kotter (1995) offer frameworks to understand the process of implementing organizational change, including BSC implementation in SMEs. These theories emphasize the importance of creating a sense of urgency, building a guiding coalition, and fostering employee the implementation process. Change management theories provide guidance on managing the organizational and human aspects of BSC implementation in SMEs.

- Contingency Theory:
Contingency theory suggests that the suitability between organizational characteristics and the chosen approach influences the effectiveness of management practices. Regarding BSC implementation in SMEs, contingency theory highlights the need to adjust the BSC framework to align with the specific characteristics of SMEs, such as size, industry, and strategy (Donaldson, 2001). This theory emphasizes the importance of customization and adaptation in BSC implementation to enhance its relevance and effectiveness in SMEs.

Being integral to Indonesia's small and medium-sized enterprise (SME) landscape, Central Java and Yogyakarta emerge as strategically significant regions for business development. Despite the promising potential these areas offer, there exists a notable gap in SMEs' awareness regarding effective business evaluation and profit maximization strategies. This research seeks to address this gap by investigating and measuring the impact of various perspectives within the balanced scorecard framework on SME performance.

The primary objective of this study is to identify and understand which specific elements of the balanced scorecard framework significantly influence the performance of SMEs in Central Java and Yogyakarta. By doing so, the research endeavours to equip SMEs in these regions with valuable insights and tools to enhance their business operations. The findings of this study aim to serve as a roadmap for SMEs, offering a comprehensive overview of key performance indicators and strategic perspectives that can contribute to the improvement of their businesses.

Fundamentally, this research endeavours to fill the existing knowledge void within the small and medium-sized enterprise (SME) community, offering practical insights that empower businesses in Central Java and Yogyakarta to make well-informed decisions. Through a comprehensive exploration of the effects of balanced scorecard perspectives on performance, the study seeks to play a pivotal role in propelling the overall progress and sustainability of SMEs in these strategically vital regions.

The overarching goal is to provide actionable knowledge that translates into tangible benefits for SMEs, enabling them to navigate the complexities of their business environment with a heightened level of understanding. By shedding light on the specific ways in which balanced scorecard perspectives can impact performance, the research aims to equip SMEs in Central Java and Yogyakarta with valuable tools to enhance their operational efficiency and strategic decision-making processes.

Ultimately, the aspiration is to contribute to the long-term success and resilience of SMEs in these regions, fostering an environment where businesses are not only informed but also empowered to thrive in the ever-evolving landscape of commerce.

Research shows that the adoption of the balanced scorecard perspective has a positive effect on SMEs' performance. A study conducted by Collis and Jarvis (2002) found that SMEs that adopted the balanced scorecard approach outperformed those that did not. Similarly, Ismail et al. (2011) observed that SMEs that implemented the balanced scorecard methodology achieved better performance outcomes. More importantly, SMEs that applied the balanced scorecard approach experienced improved communication and collaboration among different departments, increased employee engagement, and a better understanding of their strategic objectives (Lo et al., 2007). This holistic approach encourages SMEs to focus on non-financial performance indicators, such as customer loyalty and training for employees, which are critical drivers of long-term growth and sustainability.

3. Method

This research investigates the balanced scorecard perspective in micro, small, and medium enterprises. We test whether the implementation of a balanced scorecard affects the performance of SMEs. Specifically, we test the effect of the implementation of a balanced scorecard on SMEs' performance in SMEs in Central Java and Yogyakarta.

The sector of the business is about F&B, fashion, craft, and services. We conducted online and offline surveys of 170 respondents. We cleaned our data to drop the incomplete answer and leave 164 observations. The survey aims to explain the effect of a balanced scorecard which has four major perspectives: (1) financial, (2) customer, (3) internal process, and (4) organizational learning and growth (Tompson & Mathys, 2008).

We use the balanced scorecard perspective as the independent variable and performance as the dependent variable. Based on Pal et al., 2008, the adoption of digital technology will improve SMEs' competitiveness and performance. Therefore, we also conduct digitalization as the independent variable.

We use control variables such as the gender of the respondent, education, the sector of SMEs, and the size of SMEs. We separate the gender into men and women, the education into less educated and educated, and the sector of SMEs: Food and Beverages, Fashion, Craft, Services, and others. We also test whether the effect of the implementation of the balanced scorecard is different based on the gender of the respondent, the education, the sector of SMEs, and the size of SMEs.

We separate the size of SMEs based on the regulation UU No. 20 2008, which states that Micro Enterprises the enterprises with Assets of less than 50 million rupiahs and Turnover less than 300 million rupiahs, then small enterprises are enterprises with Assets 50 million rupiahs until 500 Million rupiahs and Turnover Between 300 Million rupiahs until 2.5 Billion rupiahs and medium enterprises are the Enterprises with assets more than 500 million rupiahs until 10 billion rupiahs and turnover more than 2.5 billion rupiahs until 50 billion rupiahs. We test to understand the possibility of the different impacts of the balanced scorecard implementation based on the firm size.

The baseline model is:
$$PERFORMANCE = \alpha + \beta_1 FINANCE_i + \beta_2 CUSTOMER_i + \beta_3 PROCESS_i + \beta_4 LEARNGROWTH_i + \beta_5 GENDER_i + \beta_6 AGE_i + \beta_8 EDU_i + \beta_9 SECTOR_i + \beta_2 SMESIZE_i \, \varepsilon_i \ldots (1)$$

4. Results and discussion

The balanced scorecard effect on SMEs' performance is unique. We find that the factor that has a significant effect on SME's performance is only the SME's customer. The indicator that supports SME's performance is when: 1) The SMEs always follow the customer needs, 2) Customer repeat buying, 3) Customer satisfaction, 4) The ability of customers to give suggestions, and 5) The SMEs have a loyalty program. Customer satisfaction and loyalty are very important to SMEs' performance and affect SMEs' profitability.

Table 1. Results

	PERFORMANCE
FINANCE	0,097916667
	(0.0658)
CUSTOMER	**0.356****
	(0.121)
PROCESS	0,095138889
	(0.0938)
LEARNGROWTH	**0.146***
	(0.0630)
GENDER	0,097916667
	(0.0881)
AGE	0.00138
	(0.00352)
EDU	0.00723
	(0.0335)
SECTOR	-0.0152
	(0.0317)
SMESIZE	0,378472222
	(0.110)
_cons	**0.784***
	(0.396)
N	164
R²	0,278472222
adj. R²	0,251388889
RMSE	0,353472222

Standard errors in parentheses
* p < 0.05, ** p < 0.01, *** p < 0.001

Then we test the effect of SMEs based on the SME sector. The sectors we test are food and beverages, fashion, craft, services, and other sectors. The other business mostly comes from furniture production. From that test, we find that the implementation of a balanced scorecard perspective does not affect the SME's performance. We find a significant sign of the customer variable. This finding indicates that the loyalty of the customer will affect the SME's performance.

In examining various sectors within SMEs, including fashion, craft, and services, there is a lack of notable results regarding the impact of implementing the balanced scorecard perspective on SME performance. This outcome aligns with the findings of Rompho (2011), who similarly highlighted challenges in the successful adoption of the balanced scorecard perspective among SMEs. The common thread in these observations is the tendency of SMEs to frequently change strategies, contributing to the ineffectiveness of implementing the balanced scorecard perspective within these enterprises.

The study identifies the frequent changes in strategy within small and medium-sized enterprises (SMEs) as a pivotal factor impeding the effective application of the balanced scorecard perspective. This continuous and dynamic evolution of strategies within SMEs creates a challenging environment, hindering the establishment of a consistent framework that aligns seamlessly with the principles of the balanced scorecard.

The fluid nature of SME strategies poses a significant obstacle, preventing the formulation and maintenance of a standardized approach that can fully adhere to the principles and objectives of the balanced scorecard. Consequently, this lack of consistency results in a failure to realize the intended benefits of employing the balanced scorecard as a strategic management tool. The inherent challenge lies in the difficulty of integrating a dynamic strategy environment with the structured framework that the balanced scorecard seeks to provide, ultimately impeding its efficacy within the dynamic landscape of SMEs.

Table 2. Regression results

	(1)	(2)	(3)	(4)	(5)	(6)
FINANCE	0.0141	-0.0304	-0.113	-0.107	0.276	-0.0850
	(0.0658)	(0.0775)	(0.140)	(0.175)	(0.279)	(0.312)
CUSTOMER	**0.356****	**0.672*****	**0.659***	-0.0993	-0.207	0.393
	(0.121)	**(0.121)**	**(0.297)**	(0.290)	(0.287)	(0.633)
PROCESS	0.137	0.133	0.267	0.355	0.112	0.155
	(0.0938)	(0.0981)	(0.417)	(0.295)	(0.198)	(0.408)
LEARNGROWTH	0.146*	0.0468	-0.00578	0.0548	0.0805	0.149
	(0.0630)	(0.106)	(0.344)	(0.140)	(0.202)	(0.181)
GENDER	0.141	**0.306***	-0.267	0.404	0.639	-0.0396
	(0.0881)	**(0.120)**	(0.270)	(0.322)	(0.323)	(0.347)
AGE	0.00138	0.00455	0.00451	0.00146	0.01000	0.00401
	(0.00352)	(0.00400)	(0.00911)	(0.0145)	(0.0134)	(0.0254)
EDU	0.00723	0.0622	-0.0259	-0.0130	-0.170	-0.103
	(0.0335)	(0.0555)	(0.112)	(0.121)	(0.118)	(0.223)
SECTOR	-0.0152	.	.	.	.	.
	(0.0317)	.	.	.	.	.
SMESIZE	0.0545	-0.0759	-0.553	0.779	-0.139	0.0875
	(0.110)	(0.156)	(0.387)	(0.416)	(0.195)	(0.237)
_cons	**0.784***	-0.319	0.355	2.084	2.557	1.400
	(0.396)	(0.397)	(1.508)	(1.183)	(1.797)	(2.228)
N	164	60	23	29	24	28
R^2	0.401	0.645	0.792	0.303	0.621	0.318
adj. R^2	0.362	0.581	0.647	-0.027	0.378	-0.023
rmse	0.509	0.343	0.384	0.632	0.492	0.832

Standard errors in parentheses
* p < 0.05, ** p < 0.01, *** p < 0.001

It is noteworthy that the study did not explore the implementation of the balanced scorecard perspective based on the size of SMEs due to the omission of certain observations. Consequently, the impact of size-related variables on the effectiveness of the balanced scorecard remains unexamined in this particular research. This limitation suggests a potential avenue for future research to delve deeper into the nuanced factors that might influence the success or failure of implementing the balanced scorecard perspective in SMEs, especially considering the diverse nature of these enterprises.

The results of this study underscore the pivotal role played by customer satisfaction and loyalty as a determining factor in the performance of small and medium-sized enterprises (SMEs). The significance of these findings resonates with the widely accepted belief that the contentment and loyalty of customers exert a substantial influence on the profitability and overall success of SMEs.

This empirical evidence reinforces the understanding that, within the intricate landscape of SME operations, the satisfaction and loyalty of customers stand out as key drivers of positive performance outcomes. The linkage between customer satisfaction and SME profitability is highlighted, emphasizing the direct and tangible impact that a content and loyal customer base can have on an enterprise's financial health and overall effectiveness.

As SMEs navigate the competitive business environment, recognizing the paramount importance of fostering customer satisfaction and loyalty becomes imperative. These findings not only validate the strategic emphasis on customer-centric approaches but also underscore the need for SMEs to invest in practices and initiatives that enhance the overall experience for their clientele, ultimately contributing to sustained success and growth. The indicators that support SMEs' performance in relation to customer satisfaction and loyalty are identified as follows:

✓ Meeting customer needs: SMEs that consistently align their products or services with customer demands and preferences are more likely to achieve higher performance levels.
✓ Repeat buying: The frequency at which customers make repeat purchases from SMEs indicates a positive customer experience and satisfaction with the products or services offered.
✓ Customer satisfaction: The level of satisfaction reported by customers indicates their contentment with the quality, features, and overall value provided by the SMEs.
✓ Customer suggestions: When customers are actively engaged and able to provide suggestions for improvement, it demonstrates their interest and involvement in the SMEs' offerings.
✓ Loyalty program: The presence of a loyalty program encourages customers to continue engaging with the SMEs, promoting customer loyalty and repeated business.

These research findings underscore the paramount importance of adopting customer-centric strategies as catalysts for enhancing the performance and profitability of small and medium-sized enterprises (SMEs). Emphasizing customer satisfaction and loyalty emerges as a strategic imperative, with potential benefits including increased sales, positive word-of-mouth referrals, and the establishment of a foundation for sustainable growth.

Furthermore, the study delved into the impact of implementing the Balanced Scorecard (BSC) across various sectors, encompassing food and beverages, fashion, craft, services, and others, including furniture production. Surprisingly, the results indicate that the implementation of BSC perspectives did not yield a statistically significant effect on SME performance within these diverse sectors. Despite this lack of correlation, the persistent significance of the customer variable in influencing SME performance reinforces the crucial role of customer satisfaction and loyalty.

These outcomes shed light on the nuanced dynamics at play within SMEs, suggesting that, while the adoption of BSC perspectives may not uniformly impact performance across different sectors, a customer-centric focus consistently emerges as a key driver of success. The findings thus advocate for a strategic emphasis on customer relationships and service quality, encouraging SMEs to prioritize customer satisfaction and loyalty initiatives as integral components of their overarching business strategies.

The discovery aligns with the conclusions drawn by Rompho (2011), whose research similarly highlighted challenges in implementing the Balanced Scorecard (BSC) in small and medium-sized enterprises (SMEs). Both studies identify the recurring issue of BSC framework failure in SMEs, attributing it to the dynamic nature of these businesses, characterized by frequent shifts in strategies. This inherent tendency among SMEs to adapt and change strategies proves to be a significant obstacle to the effective implementation of the BSC framework.

It is noteworthy that the current study did not delve into an analysis of the BSC implementation based on the size of SMEs, a decision driven by the limited number of observations available. Despite this limitation, the key takeaway from the findings underscores the critical importance for SMEs to place a high priority on factors such as customer satisfaction and loyalty. These elements emerge as pivotal contributors to improved performance and sustained long-term success, serving as integral components that can compensate for the challenges associated with BSC implementation in the dynamic landscape of SMEs. The emphasis on customer-centric strategies becomes particularly relevant in light of the observed hurdles in effectively applying the BSC framework in SMEs.

5. Conclusion

In the initial examination, the research uncovered a noteworthy impact of customer variables on the performance of small and medium-sized enterprises (SMEs). Specifically, it was identified that factors such as customer loyalty and repeat purchasing behavior positively influence the overall performance of SMEs, indicating the substantial role customers play in driving success.

Furthermore, the study revealed a nuanced insight into the applicability of the balanced scorecard perspective. Notably, the findings indicate that this strategic framework appears to be more

pertinent and effective when implemented by SMEs operating in the food and beverages sector. However, the impact of balanced scorecard implementation was found to be statistically insignificant in other sectors such as fashion, craft, services, and miscellaneous fields. This suggests a sector-specific variance in the effectiveness of the balanced scorecard approach, emphasizing the importance of tailoring management strategies to the unique characteristics and challenges within each industry. In essence, these findings underline the significance of customer-related variables as potent drivers of SME performance while shedding light on the sector-specific considerations that should be taken into account when contemplating the implementation of strategic frameworks like the balanced scorecard.

We recommend that small and medium-sized enterprises (SMEs) cultivate and nurture their relationships with customers. This proactive approach can lead to a boost in revenue, particularly through the patronage of loyal customers. The significance of loyal customers extends beyond mere transactions, as they often engage in word-of-mouth advertising, acting as ambassadors for the SME and attracting new customers through positive referrals.

While it may be observed that certain factors such as financial aspects, learning processes, and the SMEs' learning and growth variables may not exhibit a statistically significant impact on SME performance, it is still recommended to prioritize these variables. This is because they can contribute to overall customer satisfaction, a crucial element in sustaining and expanding a customer base. Therefore, even in the absence of a direct correlation with performance metrics, attending to these variables can indirectly influence customer loyalty and satisfaction, ultimately contributing to the success of the SME.

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